

**LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

200 W. Washington, Suite 301
Indianapolis, IN 46204
(317) 233-0696
<http://www.in.gov/legislative>

FISCAL IMPACT STATEMENT

LS 6126

BILL NUMBER: SB 36

NOTE PREPARED: Nov 6, 2007

BILL AMENDED:

SUBJECT: Taxation of Civil Service Annuities.

FIRST AUTHOR: Sen. Landske

FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: This bill increases the civil service annuity income tax deduction from \$2,000 to \$10,000 over a seven year phase-in period. It also provides that the deduction is available to a surviving spouse.

Effective Date: January 1, 2008 (retroactive).

Explanation of State Expenditures: *Summary:* The bill would reduce Adjusted Gross Income (AGI) Tax liabilities of certain individual taxpayers who receive federal civil service retirement benefits and currently claim the maximum \$2,000 deduction for this income. The bill phases in an increase in the deduction from \$2,000 to \$10,000 over seven years. The potential revenue loss due to the increase in the deduction is summarized in the table below.

Tax Year	Maximum Deduction	Annual Revenue Loss
2008 and 2009	\$4,000	\$161,500
2010 and 2011	\$6,000	\$296,500
2012 and 2013	\$8,000	\$408,000
2014 and after	\$10,000	\$500,000

The fiscal year impact of the deduction would begin in FY 2009. If recent trends persist, the annual revenue

loss after the phase-in is complete could potentially decline by about 4.2%. The impact of extending the deduction to a surviving spouse could potentially increase the revenue loss from the bill, but the extent of the impact is unknown.

Background Information: Under current statute, taxpayers may deduct up to \$2,000 in civil service annuity income. The deduction is equal to the difference between \$2,000 and the total amount of social security and railroad benefits received by the taxpayer. State tax return data indicates that 3,623 taxpayers deducted approximately \$6.2 M in civil service annuity pay from AGI in 2005. This amount resulted in a revenue loss of about \$212,000. From 2000 to 2005, this deduction declined by an average of 4.2% per year.

It is assumed that taxpayers currently claiming the maximum deduction do not receive social security or railroad retirement benefits. Based on the average benefits cited above, it is also assumed that these taxpayers would also be able to claim the maximum deductions established in the bill. In 2005, 2,745 taxpayers claimed the maximum deduction, 72 of whom claimed a \$4,000 deduction on joint returns. This total declined by about 4.6% annually since 2000. *(Additional information in regard to the number of federal retirees residing in Indiana and their associated civil service annuity payments for 2007 will be added as the data becomes available. This information will not impact the estimates.)*

The bill increases the deduction beginning in tax year 2008, thus, the fiscal impact of the phase-in will commence in FY 2009. Eighty-six percent of the revenue from AGI Tax on individuals is deposited in the state General Fund, and 14% of the revenue is deposited in the Property Tax Replacement Fund.

Explanation of Local Expenditures:

Explanation of Local Revenues: Because the increase in the civil service retirement deduction would serve to decrease taxable income, counties imposing local option income taxes could potentially experience a minimal decrease in revenue from these taxes.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties with local option income taxes.

Information Sources: OFMA Income Tax databases, 1996-2005; Sean Hershey, Federal Office of Personnel Management, 202-606-4175.

Fiscal Analyst: Hannah Mongiat, 232-9867